

## Message Text

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ACTION EUR-12

INFO OCT-01 EA-07 ISO-00 CIAE-00 DODE-00 PM-04 H-02 INR-07

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FM AMEMBASSY ROME

TO SECSTATE WASHDC PRIORITY 5498

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AMEMBASSY BONN

AMEMBASSY BRUSSELS

USMISSION EC BRUSSELS

AMEMBASSY LONDON

AMCONSUL MILAN

AMCONSUL NAPLES

AMEMBASSY OTTAWA

AMEMBASSY PARIS

USMISSION OECD PARIS

AMEMBASSY STOCKHOLM

AMEMBASSY THE HAGUE

AMEMBASSY TOKYO

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E.O. 11652: N/A

TAGS: EFIN, IT

SUBJECT: PRESS SPECULATION ON EMERGENCY ECONOMIC PROGRAM

PASS TREASURY AND FRB

REF: (A) ROME 1561; (B) ROME 861; (C) ROME 1290; (D) ROME 1645

SUMMARY. ITALIAN WEEKEND NEWSPAPERS SPECULATED ON  
POSSIBLE EMERGENCY ECONOMIC MEASURES BEING FORMULATED  
BY CHRISTIAN DEMOCRATS FOR PRESENTATION TO OTHER PARTIES  
IN EFFORT TO FORM NEW GOVERNMENT WITH ACCEPTABLE ECONOMIC  
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PROGRAM. MAIN ELEMENTS OF PROGRAM BEING DEVELOPED ARE

SAID TO INCLUDE: (1) MODERATELY MORE RESTRICTIVE MONETARY POLICY, (2) STAND-BY TAX PACKAGE, (3) ASSUMPTION BY GOI OF SOCIAL INSURANCE COSTS OF EXPORTING FIRMS, (4) FREE FLOATING EXCHANGE RATE FOLLOWED BY RESUMPTION OF INTERVENTION WITHIN WIDE EXCHANGE RATE BAND, AND (5) PHASED INCREASE IN WAGE RATE INCREASES CURRENTLY BEING NEGOTIATED. MEASURES REGARDING ASSISTANCE TO WORKERS IN SELECTED SPECIFIC FIRMS NOW IN DIFFICULTY ARE BEING REPORTED SEPTEL. END SUMMARY.

1. MONETARY POLICY. EFFECTIVE FEBRUARY 2, BOI DISCOUNT RATE AND BASIC RATE ON BOI ADVANCES WERE INCREASED FROM 6 TO 7 PERCENT. INCREASE REFLECTED ALREADY APPARENT GOI POLICY OF ENCOURAGING MODERATE INCREASE IN SHORT-TERM INTEREST RATES, WHILE AVOIDING INCREASE IN MEDIUM AND LONG-TERM RATES (SO AS TO PREVENT ADVERSE IMPACT ON INVESTMENT). INTERBANK RATES AND TREASURY BILL RATES HAVE ALREADY RISEN, AND SOME INCREASE IN BANK CARTEL'S DE FACTO PRIME RATE IS EXPECTED.

2. FISCAL POLICY. PRESS REPORTS THAT PROPOSAL IS BEING EXAMINED TO SEEK APPROVAL FROM PARLIAMENT OF TAX INCREASE PACKAGE DESIGNED TO GENERATE 2,000 BILLION LIRE IN NEW REVENUE. PACKAGE WOULD NOT BE PUT INTO EFFECT IMMEDIATELY, BUT WOULD BE AVAILABLE ON STAND-BY BASIS FOR USE AS NEEDED.

3. FISCALIZATION OF SOCIAL COSTS. PROPOSAL FOR "FISCALIZATION" OF SOCIAL COSTS (GOVERNMENT ASSUMPTION OF SOCIAL INSURANCE COSTS OF BUSINESS) WOULD REPORTEDLY BE LIMITED TO FIRMS IN EXPORT SECTOR.

4. EXCHANGE RATE POLICY. PRESS SPECULATES THAT AFTER CURRENT PERIOD OF FREE FLOAT BOI WOULD RESUME INTERVENTION IN MARKET ON MORE MODEST SCALE THAN IN PAST, ALLOWING RATE TO FLUCTUATE WITHIN RATHER WIDE EXCHANGE RATE BAND. ONE NEWSPAPER SUGGESTED BAND IS RANGE 710 TO 760 LIRE PER DOLLAR.

5. INCOMES POLICY. GRADUAL PHASING IN OF WAGE CONTRACT IN-LIMITED OFFICIAL USE

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CREASES NOW BEING NEGOTIATED MAY BE PROPOSED SO THAT IMPACT OF WAGE COST INCREASE WOULD BE SPREAD OVER LONGER TIME PERIOD.

6. COMMENT. WARNINGS HAVE BEEN ISSUED BY LABOR UNIONS AND BY SOCIALISTS AGAINST IMPOSITION OF TIGHT CREDIT SQUEEZE, SO THAT ECONOMIC RECOVERY WILL NOT BE NIPPED IN THE BUD. HOWEVER, AS TREASURY MINISTER COLOMBO POINTED OUT IN HIS TESTIMONY BEFORE SENATE COMMITTEE LAST WEEK (REFTEL A), PARTIAL RENUNCIATION OF

USE OF MONETARY POLICY TOOL MEANS THAT OTHER TOOLS SUCH AS FISCAL POLICY AND INCOMES POLICY MUST BE USED TO DEAL WITH CRITICAL FINANCIAL AND ECONOMIC PROBLEMS.

7. REPORTS OF STAND-BY FISCAL PACKAGE FOLLOW EARLIER SPECULATION THAT GOI WAS CONSIDERING INCREASES BOTH IN INDIRECT TAXES (E.G., VALUE-ADDED TAX ON LUXURY PRODUCTS AND INCREASE IN GASOLINE TAX) AND IN INCOME TAX RATES. APPARENTLY PARLIAMENTARY APPROVAL WOULD BE SOUGHT FOR INCREASING CERTAIN TAXES TO MEET GROWING CASH BUDGET DEFICIT, BUT ACTUAL IMPLEMENTATION OF TAX INCREASES WOULD BE TIMED TO FIT BUSINESS CYCLE DEVELOPMENTS. MINISTER OF FINANCE VISENTINI IS SAID TO BE OPPOSED TO INCOME TAX RATE INCREASES AS BEING INCONSISTENT WITH REDUCTION IN TAX RATES DESIGNED TO AVOID EFFECTS OF FISCAL DRAG INCREASE IN EFFECTIVE TAX RATES DUE TO INFLATION WHICH WAS CONTAINED IN DECEMBER 1975 "MINI-REFORM."

8. IDEA OF WIDE-SCALE FISCALIZATION OF SOCIAL INSURANCE COSTS (SEE ABOVE) HAD BEEN RAISED IN CONNECTION WITH ANTI-RECESSION PACKAGE LAST SUMMER AND REJECTED AS TOO COSTLY. INITIAL PSI ECONOMIC PROGRAM FOLLOWING FALL OF GOVERNMENT REPORTEDLY INCLUDED PROPOSAL FOR PARTIAL FISCALIZATION (REFTEL B). REVIVAL OF THIS IDEA BY DC ECONOMISTS, BUT LIMITATION OF ITS APPLICATION TO EXPORT FIRMS, REFLECTS INCREASED IMPORTANCE ATTACHED TO BALANCE OF PAYMENTS PROBLEM FOLLOWING JANUARY LIRA CRISIS. ON OTHER HAND, THERE IS STILL CONCERN ABOUT EXCESSIVELY LARGE NEW BURDEN ON BUDGET. SOME RESISTANCE HAS BEEN EXPRESSED TO THIS IDEA ON GROUNDS THAT NEW HIGHER EXCHANGE RATE ALREADY PROVIDES SUFFICIENT INCENTIVE FOR EXPORTERS.

9. NEWSPAPERS SPECULATE THAT RESUMPTION OF EXCHANGE MARKET INTERVENTION BY BOI WILL BE ON LIMITED SCALE, SO AS TO AVOID CREATING SITUATION FAVORING ONE-WAY SPECULATION DUE TO ESTABLISHED LIMITED OFFICIAL USE

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MENT OF IMPLICIT FLOOR ON LIRA VALUE. ONE PAPER SUGGESTED THAT BANK MIGHT INTERVENE WITHIN WIDE BAND IN RANGE 710 TO 760 LIRE PER DOLLAR, I.E., 3.3 TO 10.6 PERCENT BELOW RATE WHICH PREVAILED ON JANUARY 20 JUST BEFORE BOI WITHDREW FROM MARKET. (ON JANUARY 30, DOLLAR-LIRA RATE WAS ABOUT 751 CALCULATED THROUGH FRANKFURT CROSSRATES.)

10. IDEA OF REDUCED WAGE RATE DEMANDS SPREAD OUT OVER THREE-YEAR CONTRACT PERIOD HAD ALREADY BEEN FLOATED BY PRIME MINISTER'S ECONOMIC ADVISER ANDREATTA NOT LONG AGO (REFTEL C). PREDICTABLY, REACTION OF THREE LABOR FEDERATIONS WAS NEGATIVE, ALTHOUGH CISL AND UIL, IN PARTICULAR, SEEM TO HAVE EVIDENCED SOME SYMPATHY FOR TAKING PRESENT CRISIS INTO ACCOUNT IN FORMULATING THEIR DEMANDS.

11. ALL OF ABOVE PROPOSALS ARE STILL HIGHLY UNCERTAIN AND DO NOT SUBSTITUTE FOR MEDIUM-TERM ECONOMIC PROPOSALS. THEY HAVE NOT YET BEEN APPROVED WITHIN DC PARTY NOR, AS YET, PRESENTED TO PSI AND OTHER PARTIES. DC IS EXPECTED TO EXAMIN EMERGENCY PROPOSALS FEBRUARY 2 FOR CONSIDERATION BY PSI AROUND FEBRUARY 4 OR 5. MOST INTERESTING ELEMENTS OF PROPOSAL ARE PHASING IN OF LABOR COST INCREASES AND CREATION OF STAND-BY TAX PACKAGE, SINCE THEY COULD BE IMPORTANT FIRST STEPS IN DEALING WITH ITALY'S PERSISTENTLY HIGH INCREASES IN LABOR COSTS AND WITH ITS SHARPLY RISING BUDGET DEFICIT. UNTIL THESE TWO PROBLEMS ARE ADDRESSED SERIOUSLY, IT IS HARD TO SEE HOW ITALY CAN AVOID CHRONIC INFLATIONARY AND BALANCE OF PAYMENTS PROBLEMS" VOLPE

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## Message Attributes

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